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Nauset Market Commentary
First Quarter 2014

Market Performance Recap: **Choppy Markets, Small Gains**

The strong stock rally of the past 18 months paused in the first quarter as investors focused on sluggish growth and earnings data blamed on a cold, snowy winter across the U.S. The Russell 3000, a broad U.S. stock index, posted a Q1 gain of +2.0%. Bond prices were up slightly for the quarter as a counter to stock market volatility with the Barclays Intermediate Gov't/Credit Index increasing +1.0%.

Economic & Market Discussion: **Risk and Relative Value**

The past five years have proven that stocks can post extraordinary gains if money is cheap, growth is modestly positive, and attractive investment alternatives are few. Investors favored the relative value of stocks, while minimizing the inherent risks of equity investing. As we have posited in earlier commentaries, the stock market rally can be powered by relative value versus other asset classes as long as earnings growth and profit margins can justify valuations within historic norms. Recently, we see signs that investors are finally focusing on the fundamentals that underpin current stock market values – and risk is being considered along with relative value.

Now, this does not mean that stocks will experience a sudden significant sell-off, but rather that gains will be more difficult to attain without true top and bottom line growth from GDP expansion. And the focus on fundamentals will likely create more near-term turmoil in all financial markets. More attention is being paid to risk, particularly in areas that lack predictable growth, earnings, and high quality balance sheets, such as internet-related tech, smaller biotech, and retail as well as newly minted IPOs.

However, in our opinion, the lack of attractive alternatives to stocks does limit any potential stock market decline. We saw an example of this in January when a -5% drop in the S&P 500 was quickly followed by a +5% recovery in February. Near-zero money market returns and rising-rate risk to high quality bonds may be the best defense that stocks have against a major correction. In summary, relative values do matter and are likely to continue to push investors to take risk in stocks, though investors are getting more cautious in where to make their equity investments.

Our current strategy reflects a cautious stance with an emphasis on higher quality stock sectors as well as real asset allocations to energy infrastructure and real estate stocks. Our income allocations remain underweight and mostly defensive against the prospect of higher rates, with high yield corporates being an exception. And we continue to seek opportunity in alternative and hedged investments that can both provide returns and dampen overall portfolio risk.

Market Performance **% Change for Periods Ended 3/31/2014**

Market Index	First Quarter	2014 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 3000	1.97	1.97	22.61	14.61	21.93
MSCI EAFE – Non-US	0.66	0.66	17.56	7.22	16.01
MSCI Emerging Markets	-0.43	-0.43	-1.42	-2.86	14.48
DJ US Real Estate	8.74	8.74	2.08	9.20	27.09
BarCap Intermediate Gov't/Credit Bond	1.00	1.00	-0.12	3.13	4.18
IQ Hedge Multi-Strategy	1.12	1.12	6.14	4.23	5.17
3-Month T-Bill	0.01	0.01	0.05	0.06	0.09

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